

Report on Audits of Combined Financial Statements and Supplemental Information

as of June 30, 1999, and for the year then ended

Report of Independent Accountants

To the Teachers' Retirement Board
California State Teachers' Retirement System

In our opinion, based upon our audits and the report of other auditors, the accompanying combined statements of plan net assets and the related combined statements of changes in plan net assets present fairly, in all material respects, the plan net assets of the California State Teachers' Retirement System (System), a component unit of the State of California, as of June 30, 1999, and the changes in plan net assets for the year then ended in conformity with generally accepted accounting principles. These financial statements are the responsibility of the System's management; our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of the System's 403(b) Program. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion on those financial statements is based solely on the report of the other auditors. We previously audited and reported on the financial statements of the System for the year ended June 30, 1998, the reporting entity totals of which are included for comparative purposes only. We conducted our audits of the financial statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits and the report of the other auditors provide a reasonable basis for the opinion expressed above.



Sacramento, California
September 22, 1999

California State Teachers' Retirement System
Combined Statements of Plan Net Assets
As of June 30, 1999
With reporting entity totals as of June 30, 1999 and 1998
(in thousands)

| | State Teachers' Retirement Plan | Cash Balance Plan | 403(b) Program | <u>Reporting Entity Totals</u> | |
|---|--|-------------------------|-------------------|--------------------------------|----------------------|
| | | | | 1999 | 1998 |
| Assets | | | | | |
| Investments, at fair value: | | | | | |
| Short-term | \$ 1,019,183 | \$ - | \$ 14,592 | \$ 1,033,775 | \$ 1,738,904 |
| Debt securities: | | | | | |
| Directly held: | | | | | |
| Domestic | 25,109,537 | - | 377 | 25,109,914 | 17,752,435 |
| International | 11,639 | - | - | 11,639 | 603,994 |
| Pooled - domestic | - | - | - | - | 8,529,757 |
| Equities: | | | | | |
| Directly held: | | | | | |
| Domestic | 45,912,654 | - | 20,828 | 45,933,482 | 11,846,679 |
| International | 22,758,036 | - | 176 | 22,758,212 | 18,525,483 |
| Pooled - domestic | - | - | - | - | 24,897,824 |
| Alternative | 2,581,794 | - | - | 2,581,794 | 1,983,165 |
| Real estate | 2,169,967 | - | - | 2,169,967 | 2,061,342 |
| Securities lending collateral | 15,516,345 | - | - | 15,516,345 | 16,996,456 |
| Total investments | <u>115,079,155</u> | <u>-</u> | <u>35,973</u> | <u>115,115,128</u> | <u>104,936,039</u> |
| Cash | <u>1,932</u> | <u>-</u> | <u>-</u> | <u>1,932</u> | <u>4,409</u> |
| Receivables: | | | | | |
| Investments sold | 521,274 | - | - | 521,274 | 292,493 |
| Foreign exchange contracts | 1,582,431 | - | - | 1,582,431 | 2,250,123 |
| Interest and dividends | 437,223 | - | 228 | 437,451 | 481,936 |
| Member/employer and other | 311,857 | - | - | 311,857 | 313,363 |
| Total receivables | <u>2,852,785</u> | <u>-</u> | <u>228</u> | <u>2,853,013</u> | <u>3,337,915</u> |
| Other assets | <u>220</u> | <u>-</u> | <u>53</u> | <u>273</u> | <u>598</u> |
| Total assets | <u>117,934,092</u> | <u>-</u> | <u>36,254</u> | <u>117,970,346</u> | <u>108,278,961</u> |
| Liabilities | | | | | |
| Payable for investments purchased | 637,710 | - | - | 637,710 | 438,784 |
| Payable for foreign exchange contracts | 1,536,673 | - | - | 1,536,673 | 2,204,647 |
| Benefits in process of payment | 311,551 | - | - | 311,551 | 295,666 |
| Other liabilities | 147,086 | - | 55 | 147,141 | 118,828 |
| Securities lending obligation | 15,516,345 | - | - | 15,516,345 | 16,996,456 |
| Total liabilities | <u>18,149,365</u> | <u>-</u> | <u>55</u> | <u>18,149,420</u> | <u>20,054,381</u> |
| Net assets held in trust for pension benefits (a schedule of funding progress is presented in Schedule I) | <u>\$ 99,784,727</u> | <u>\$ -</u> | <u>\$ 36,199</u> | <u>\$ 99,820,926</u> | <u>\$ 88,224,580</u> |

The accompanying notes are an integral part of these financial statements.

California State Teachers' Retirement System
Combined Statements of Changes in Plan Net Assets
For the year ended June 30, 1999
With reporting entity totals as of June 30, 1999 and 1998
(in thousands)

| | State Teachers' Retirement Plan | Cash Balance Plan | 403(b) Program | Reporting Entity Totals | |
|--|--|-------------------------|-------------------|-------------------------|----------------------|
| | | | | 1999 | 1998 |
| Additions | | | | | |
| Contributions: | | | | | |
| Members | \$ 1,424,106 | \$ 550 | \$ 8,675 | \$ 1,433,331 | \$ 1,308,653 |
| Employers | 1,475,668 | 560 | - | 1,476,228 | 1,372,176 |
| State of California | <u>350,175</u> | <u>-</u> | <u>-</u> | <u>350,175</u> | <u>1,004,569</u> |
| Total contributions | <u>3,249,949</u> | <u>1,110</u> | <u>8,675</u> | <u>3,259,734</u> | <u>3,685,398</u> |
| Investment income: | | | | | |
| Net appreciation (depreciation) in fair value of investments | 8,905,368 | (188) | 2,647 | 8,907,827 | 9,975,314 |
| Interest, dividends and other investment income | 2,874,332 | 5 | 1,474 | 2,875,811 | 2,968,380 |
| Securities lending income | 902,503 | - | - | 902,503 | 1,066,103 |
| Less investment expenses: | | | | | |
| Cost of lending securities | (839,430) | - | - | (839,430) | (1,016,704) |
| Other | <u>(44,974)</u> | <u>-</u> | <u>-</u> | <u>(44,974)</u> | <u>(40,577)</u> |
| Net investment income (loss) | <u>11,797,799</u> | <u>(183)</u> | <u>4,121</u> | <u>11,801,737</u> | <u>12,952,516</u> |
| Other income | <u>115</u> | <u>-</u> | <u>-</u> | <u>115</u> | <u>748</u> |
| Total additions | <u>15,047,863</u> | <u>927</u> | <u>12,796</u> | <u>15,061,586</u> | <u>16,638,662</u> |
| Deductions | | | | | |
| Retirement, death and survivor benefits | 3,145,242 | - | 237 | 3,145,479 | 2,923,918 |
| Refunds of member contributions | 74,616 | 3 | 1,610 | 76,229 | 70,709 |
| Purchasing power benefits | 197,860 | - | - | 197,860 | 179,385 |
| Administrative expenses | 45,038 | 387 | 205 | 45,630 | 36,891 |
| Interest expense | <u>-</u> | <u>42</u> | <u>-</u> | <u>42</u> | <u>69</u> |
| Total deductions | <u>3,462,756</u> | <u>432</u> | <u>2,052</u> | <u>3,465,240</u> | <u>3,210,972</u> |
| Net increase prior to transfer of net assets | <u>11,585,107</u> | <u>495</u> | <u>10,744</u> | <u>11,596,346</u> | <u>13,427,690</u> |
| Transfer of net assets upon merger of funds (Note 1) | <u>1,285</u> | <u>(1,285)</u> | <u>-</u> | <u>-</u> | <u>-</u> |
| Net increase (decrease) | <u>11,586,392</u> | <u>(790)</u> | <u>10,744</u> | <u>11,596,346</u> | <u>13,427,690</u> |
| Net assets held in trust for pension benefits: | | | | | |
| Beginning of year | <u>88,198,335</u> | <u>790</u> | <u>25,455</u> | <u>88,224,580</u> | <u>74,796,890</u> |
| End of year | <u>\$ 99,784,727</u> | <u>\$ -</u> | <u>\$ 36,199</u> | <u>\$ 99,820,926</u> | <u>\$ 88,224,580</u> |

California State Teachers' Retirement System

Notes to General Purpose Financial Statements

1. Description of the System and Contribution Information

The California State Teachers' Retirement System (System) is the administrator of cost-sharing multiple-employer pension plans and a tax-deferred supplemental program, as described below, established and administered by those sections of the State Education Code known as the Teachers' Retirement Law (Section 22000 et. seq.), as amended and enacted by the State of California (State) Legislature. The System is a component unit of the State of California. These financial statements include only the accounts of the System. The System's financial statements are included as a trust fund in the financial statements of the State of California. The System provides pension benefits to California full-time and part-time public school teachers from preschool through grade fourteen and certain other employees of the public school system.

State Teachers' Retirement Plan (STRP)

Effective January 1, 1999, Senate Bill (SB) 2085 authorized the merger of the System's Cash Balance Plan (CB Plan) and the Defined Benefit Plan (DB Plan) to establish the State Teachers' Retirement Plan (STRP). SB 2085 provides, among other things, that both the Defined Benefit Program (DB Program) and the Cash Balance Benefit Program (CBB Program) shall be administered under the Teachers' Retirement Law and be known and cited as the STRP. The cost of program administration for the six months ended June 30, 1999, is allocated proportionately to each program based on the assets of the separate programs. The prior loan from the DB Plan to the CB Plan was discharged by the creation of the STRP.

Upon the merger, the net assets of the CB Plan were combined with the net assets of the DB Plan and interfund balances were eliminated. The total CB Plan net assets transferred on January 1, 1999, was (in thousands):

| | |
|-------------------------------|-----------------|
| Investments and other assets | \$ 2,703 |
| Liabilities | (1,418) |
| Net asset transferred to STRP | <u>\$ 1,285</u> |

The combined statement of changes in plan net assets of the CB Plan reflects the activity for the six-month period ended December 31, 1998. The combined statement of changes in plan net assets of the STRP reflects activity of the CBB Program for the six-month and of the DB Program for twelve-month periods ended June 30, 1999.

California State Teachers' Retirement System

Notes to General Purpose Financial Statements

Defined Benefit Program (DB Program)

The DB Program, is a defined benefit pension plan which operates under the Internal Revenue Code (IRC). At June 30, 1999, there were approximately 1,160 contributing employers (school districts, community college districts, county offices of education and regional occupational programs). The State is a non-employer contributor to the TRP. Membership is mandatory for all employees meeting the eligibility requirements. At June 30, 1998, membership consisted of:

| | |
|---|----------------|
| Active members: | |
| Vested | 230,498 |
| Nonvested | 155,032 |
| Inactive members | 61,848 |
| Retirees and benefit recipients | 157,747 |
| Total members, retirees and beneficiaries | <u>605,125</u> |

Information as of June 30, 1999, will not be available until November 1999.

The DB Program provides defined retirement benefits based on members' final compensation, age, and years of credited service. In addition, the retirement program provides benefits to members upon disability, and to survivors upon the death of eligible members. Benefit provisions include:

- After five years of credited California service, members become 100% vested in retirement benefits earned to date. Members are eligible for normal retirement at age 60. The normal retirement benefit is equal to 2% of final compensation for each year of credited service. Effective January 1, 1999, retirements after age 60 are subject to a factor which increases with each quarter year of age to 2.4% at age 63 or older. In addition, members retiring on or after January 1, 1999, who have 30 years or more of credited service shall receive an additional 0.2% of final compensation. In no event shall the total benefit factor exceed 2.4%.

Final compensation is defined as the highest average annual compensation earnable during either any three consecutive years of credited service, or for classroom teachers, twelve consecutive months if the employer elects to pay the additional cost. Early retirement options are available at age 55 or as early as age 50 with 30 years of credited service.

- After five years of credited California service, a member (prior to age 60 if under Coverage A, no age limit if under Coverage B) is eligible for disability benefits of up to 50% of final compensation plus 10% of final compensation for each eligible child, up to a maximum addition of 40%. The member must have a disability that will exceed a period of twelve or more months to qualify for a benefit.
- A family benefit is available if an active member died and had at least one year of credited service.
- Members' accumulated contributions are refundable with interest upon separation from the System. The 1998-99 fiscal year rate of interest credited to members' accounts is 6%.

California State Teachers' Retirement System

Notes to General Purpose Financial Statements

Purchasing power protection is provided to those benefit recipients whose purchasing power has been reduced below certain levels. The purchasing power protection is funded by a combination of School Lands Revenue and Supplemental Benefit Maintenance Account (SBMA) contributions. School Lands Revenue is appropriated pursuant to Public Resources Code Section 6217.5 from the use of school lands.

The Cecil Green/William Campbell/Dave Elder Act (Act) of 1989 (Education Code Section 22954) established the SBMA to provide annual distributions (in quarterly payments) to retired and disabled members, and beneficiaries in order to restore purchasing power to a minimum of 68.2% of the initial monthly allowance. The Mrs. Ruth Q. dePrida Pension Protection Act, SB 1026 (Schiff), Chapter 939, Statutes of 1997 increased the minimum purchasing power to 75%, effective January 1, 1998. The State's contributions for the year ended June 30, 1999, were sufficient to meet the purchase power obligations.

Required Contributions

Required member and employer contribution rates are set by the Teachers' Retirement Law. Required contribution rates are expressed as a level percentage of payroll using the entry age normal actuarial cost method. The System also uses the level percentage of payroll method to calculate the amortization of any unfunded liability.

A summary of statutory rates and other sources of contributions to the System is as follows:

| | | |
|---------------------|---|--|
| Members | - | 8% of applicable member earnings |
| Employers | - | 8.25% of applicable member earnings |
| State of California | - | The enactment of SB 1370 (Ed. Code Section 22955), known as the "Elder Full Funding Act," provides for eventual full funding for the System. The provisions of the bill which became effective July 1, 1990, replaced the prior State contribution with a new funding mechanism beginning July 1, 1991. The State's annual contribution to the System is 4.3% of the previous calendar year's member payroll. Subsequent to achieving a fully funded System, the State will contribute only the amount necessary to help fund the normal cost of the current benefit program unless a subsequent unfunded obligation occurs. |

The enactment of Chapter 967, Statutes of 1998 (AB 2804) provides for funding from the State General Fund (General Fund) to maintain the fully funded status of benefits in place as of July 1, 1990, and provides funding for benefit enhancements enacted effective January 1, 1999. The provisions of Chapter 967 amended the State's contribution requirements under the Elder Full Funding Act.

California State Teachers' Retirement System

Notes to General Purpose Financial Statements

Beginning July 1, 1999, under Education Code Section 22955, the General Fund shall transfer annually to the DB Program an amount equal to 3.102% of total creditable earnings of the immediately preceding calendar year to fund certain benefit enhancements effective January 1, 1999. However, subsequent to June 30, 1999, the actuaries for the DB Program determined that the estimated General Fund contributions needed to fund the January 1, 1999, benefit enhancements would be approximately 3.150% if the shortfall is funded by assets currently available on an actuarial basis. Management believes that there are sufficient assets available on an actuarial basis to fund this increased actuarial accrued liability.

- A statutory contribution rate of 0.307% of payroll under Education Code Section 22952, which was eliminated as a separate contribution on October 1, 1998, and incorporated in the contribution rate specified under Education Code Section 22955. These were employer contributions appropriated by the State to the System pursuant to the Education Code.

Beginning October 1, 1998, a statutory contribution rate of 0.524%, adjustable annually in 0.25% increments up to a maximum of 1.505%, of the creditable earnings of the immediately preceding calendar year under Education Code Section 22955. This contribution is reduced to zero if there is no unfunded obligation or normal cost deficit. As of the June 30, 1998, actuarial valuation, there was no unfunded obligation or normal cost deficit for benefits in place as of July 1, 1990.

In their most recent actuarial valuation as of June 30, 1998, the System's independent actuaries determined the estimated amortization period for the unfunded obligation computed using the cost method and the statutory contribution rates in effect at June 30, 1998. Based on this valuation, the current statutory contributions are equivalent to 20.343% of covered payroll and the normal cost is 15.758% of covered payroll. At June 30, 1998, the actuarial value of the assets exceeded the actuarial accrued liability by \$3.1 billion. Certain risks related to the global financial markets may affect the fair value of the System's investment portfolio. The System's management is continually evaluating the impact of market fluctuations on the funding status of the DB Program. Such estimates could change in the near future.

Cash Balance Benefit Program (CBB Program)

The CBB Program, established under Part 14 of the California Education Code (Section 26000 et seq.) and subsequently amended by Assembly Bill (AB) 2673, is a separate defined benefit plan which operates under the IRC within the STRP designed for employees of California's public schools who are hired to perform creditable service for less than 50% of the full-time equivalent for the position.

Participation in the CBB Program is optional to school districts, community college districts, county offices of education and regional occupational programs. If a school district, community college district, county office of education, or regional occupational program elects to offer the CBB Program, each eligible employee will automatically be covered by the CBB Program, unless the member elects to participate in DB Program or an alternative plan provided by the employer within 60 days of hire.

California State Teachers' Retirement System

Notes to General Purpose Financial Statements

A summary of statutory contribution rates for the CBBP is as follows:

| | | |
|-----------|---|----------------------------------|
| Members | - | 4% of applicable member earnings |
| Employers | - | 4% of applicable member earnings |

Employers may enter into a collective bargaining agreement to pay different rates if certain minimum conditions are met. At June 30, 1999, there were nineteen contributing school districts and approximately 6,400 contributing members.

In their most recent actuarial valuation as of June 30, 1998, the CB Plan's independent actuaries determined the unfunded actuarial accrued liability to be approximately \$938,000. Management believes that the financial condition of the CBB Program will improve, as a result of the merger of the DB Plan and CB Plan, due to the larger asset base from which to fund administrative expenses.

STRS 403(b) Program (403(b) Program)

The 403(b) Program was authorized pursuant to AB 3064 and meets the requirements of the IRC Section 403(b). The 403(b) Program plan is a defined contribution plan and is open to any employee who is eligible to participate. Contributions to the program are voluntary and require no minimum limitations, however, the IRC does impose a maximum amount that can be contributed annually. At June 30, 1999, there were approximately 1,700 plan members and approximately 280 participating employers (school districts).

An agreement was entered into between the System and State Street Bank and Trust Company (SSB) on January 1, 1995, to appoint SSB as third-party administrator, record keeper and master custodian for the 403(b) Program assets. The appointment will expire on January 1, 2001. The investments are comprised of the money market, S&P 500, international index fund, self managed account and participant notes funds.

2. Summary of Significant Accounting Policies

Basis of Accounting

The accounting records of the System are maintained on the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Employer and State contributions are recognized when due and the employer or State has made a formal commitment to provide the contributions. Benefits are recognized when due and payable in accordance with System's retirement program.

New Accounting Pronouncements

During the year ended June 30, 1999, the System implemented Government Accounting Standards Board (GASB) Technical Bulletin (TB) 98-1, *Disclosures About Year 2000 Issues*, as amended by GASB TB 99-1, *Disclosures about Year 2000 Issues*, which requires the System to provide disclosures related to its commitment to make Year 2000 compliance changes or updates to computer systems and equipment. The System elected to make the required disclosures as supplemental information. The adoption of GASB TB 98-1 and GASB TB 99-1 had no impact on net assets held in trust for pension benefits at June 30, 1999.

California State Teachers' Retirement System

Notes to General Purpose Financial Statements

Use of Estimates in the Preparation of Financial Statements

The preparation of the System's financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and changes therein, and when applicable, disclosures of contingent assets and liabilities. Actual results could differ from those estimates.

Investments

The majority of the securities held in the investment portfolio at June 30, 1999, are in the custody of or controlled by the SSB, the System's master custodian. State statutes and Board policies allow investments consisting of government, corporate and international bonds, domestic and international equities, mutual funds, limited partnership holdings, real estate, mortgages and other investments.

All investments are reported at fair value. The fair values of investments are generally based on published market prices and quotations from major investment firms. In the case of debt securities acquired through private placements, fair value is computed by management based on market yields and average maturity dates of comparable quoted securities. Investments pooled within the System's reporting entity are valued based upon the fair values of the assets held in the pools. Mortgages are valued on the basis of future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Real estate equity investment fair values are based on either recent estimates provided by the System's contract real estate advisors or independent appraisers. Short-term investments are reported at cost or amortized cost, which approximates fair value.

The System presents in the combined statement of changes in plan net assets, the net appreciation (depreciation) in the fair value of its investments, which consists of the realized gains and losses and the unrealized appreciation (depreciation) on those investments. Purchase and sales of debt securities, equity securities and short-term investments are recorded on the trade date. Real estate equity transactions are recorded on the settlement date. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

There are certain market risks, credit risks, foreign currency exchange risks, or event risks which may subject the System to economic changes occurring in certain industries, sectors or geographies.

Foreign Exchange Contracts

The STRP enters into forward foreign exchange contracts for hedging purposes to minimize the short-term impact of foreign currency fluctuations on the asset positions of foreign investments. These foreign exchange contracts are reported at fair value based on published market prices and quotations from major investment firms. The STRP could be exposed to risk if the counterparties to the contracts are unable to meet the terms of their contracts. The STRP seeks to minimize risk from counterparties by establishing minimum credit quality standards and maximum credit limits.

Administrative Expenses

The 403(b) Program reimburses the STRP for administrative services provided on its behalf.

Income Taxes

The STRP is organized as tax-exempt retirement plan under the IRC. The 403(b) Program is organized as a tax-deferred supplemental program under the IRC. The System's management believes that it has operated within the constraints imposed by federal tax law.

California State Teachers' Retirement System

Notes to General Purpose Financial Statements

Investment Expense

Expenses directly associated with investment management have been included as other investment expenses. Indirect expenses have not been allocated.

Securities Lending Transactions

The System reports securities lent, the cash collateral held as assets and the related liabilities resulting from securities lending transactions on the statement of plan assets. The System also reports the costs of lending securities as investment expenses on the statement of changes in plan net assets.

3. Investments

The System's investments are categorized below to give an indication of the category risk level assumed by the System at June 30, 1999, as defined by GASB Statement No. 3. Category 1, the lowest risk, includes investments that are insured or registered or for which the securities are held by the System or its agent in the System's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the System's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty or by its trust department or agent but not in the System's name. Investment pools managed by other governments, investments held by broker-dealers under securities loans, alternative investments and real estate equity investments are not categorized.

The following table presents investments held by the STRP by type at June 30, 1999 (in thousands):

| Investment Type | Category 1 | Category 2 | Category 3 | Category Rating Not Required | Fair Value |
|--|----------------------|---------------|---------------|------------------------------------|-----------------------|
| Categorized: | | | | | |
| Short-term investments | \$ 760,862 | \$ - | \$ - | \$ 258,321 | \$ 1,019,183 |
| Debt securities | 18,560,015 | - | - | - | 18,560,015 |
| Equity securities | 59,946,661 | - | - | - | 59,946,661 |
| Alternative investments | - | - | - | 2,581,794 | 2,581,794 |
| Real estate equity investments | - | - | - | 2,169,967 | 2,169,967 |
| Securities lending collateral | 15,516,345 | - | - | - | 15,516,345 |
| Not categorized: | | | | | |
| Investments held by broker-dealers under securities loans: | | | | | |
| Debt securities | - | - | - | 6,561,161 | 6,561,161 |
| Equity securities | - | - | - | 8,724,029 | 8,724,029 |
| Total investments | <u>\$ 94,783,883</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 20,295,272</u> | <u>\$ 115,079,155</u> |

California State Teachers' Retirement System

Notes to General Purpose Financial Statements

Short-term investments of the STRP as of June 30, 1999, are comprised of the following (in thousands):

| | |
|---|--------------------|
| Surplus Money Investment Fund (State of California) | \$ 258,321 |
| Repurchase agreements | 45,650 |
| Certificates of deposit | 19,996 |
| Commercial paper | 473,822 |
| Treasury bills | 22,674 |
| Foreign currency | 84,132 |
| Short-term agencies | <u>114,588</u> |
| Total | <u>\$1,019,183</u> |

The STRP's investment in the Surplus Money Investment Fund (SMIF), administered by the State, represents various investments with average days to maturity of approximately 200 days, and is reported at amortized cost which approximates market value.

The STRP's repurchase agreement transactions at June 30, 1999, have underlying collateral with market values of approximately 102% of the cost of the repurchase agreement. The agreed-upon yield is 4% with maturity dates through July 1, 1999.

Foreign currency is comprised of international investment proceeds and income to be repatriated into U.S. dollars and funds available to purchase international securities. Foreign currency is not held as a form of investment.

State statutes and Teachers' Retirement Board policies permit the STRP to lend its securities to broker-dealers and other entities for which collateral is received with a simultaneous agreement to return the collateral for the same securities in the future. STRP has contracted with third party securities lending agents to lend domestic and international equity and debt securities. All securities loans can be terminated on demand by either STRP or the borrower. Collateral in the form of cash or other securities is required for 102% and 105% of the fair value of domestic and international securities, respectively, loaned. As of June 30, 1999, the System has no credit risk exposure to borrowers because the amounts the STRP owes the borrowers exceed the amounts the borrowers owe the System. Cash collateral is invested in short-term investments, which at year-end have a weighted-average maturity of less than 90 days, and the assets held as collateral are presented in the above table of investments held. STRP is not permitted to pledge or sell collateral securities received unless the borrower defaults. The contracts with the security lending agents require them to indemnify STRP if the borrowers fail to return the securities (or if the collateral is not sufficient to replace the securities lent) or if the borrower fails to pay STRP for income distributions by the securities' issuers while the securities are on loan.

403(b) Program

Investments held by the 403(b) Program are mutual funds and are not required to be categorized by risk levels under GASB Statement No. 3.

California State Teachers' Retirement System

Notes to General Purpose Financial Statements

4. Contingencies

The STRP is involved in litigation relating to various matters. In the opinion of management, after consultation with legal counsel, the outcome of this litigation will not have a material adverse effect on the STRP's financial position.

5. Commitments

In conjunction with purchase of various partnership interests, the STRP has remaining funding commitments of approximately \$2.5 billion at June 30, 1999.

The STRP has entered into agreements to guarantee payment of principal and interest in the event that the primary obligator defaults. The STRP is paid a fee over the term of such agreements, and in the event of default, the STRP could draw on the standby letter-of-credit for repayment. At June 30, 1999, the STRP has commitments of approximately \$679.6 million expiring through May 18, 2006. Fee income earned by the STRP was \$1.292 million for the year ended June 30, 1999.

Supplemental Information

**Report of Independent Accountants on
Required Supplementary Information**

To the Teachers' Retirement Board
California State Teachers' Retirement System

Our report on the audits of the financial statements of the California State Teacher's Retirement System (System) as of June 30, 1999, and for the year then ended is presented in the first section of this document. Our audits were made for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental information included in Schedules 1 and 2 is required under GASB Statement No. 25, *Financial Reporting For Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*. The supplemental information included in Schedules 3 through 8 is presented for purposes of additional analysis and is not a required part of the financial statements. Such information for the years ended June 30, 1999, 1998, 1997, 1996, 1995 and 1994, has been subjected to the auditing procedures applied in the audits of the financial statements and, in our opinion and based on the report of other auditors, is fairly stated, in all material respects, in relation to the financial statements taken as a whole from which it has been derived.

The Year 2000 supplementary information in Schedule 9 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board (GASB), and we did not audit and do not express an opinion on such information. Further, we were unable to apply to the information certain procedures prescribed by professional standards because the disclosure criteria specified by GASB Technical Bulletin 98-1, as amended, are not sufficiently specific and therefore, preclude the prescribed procedures from providing meaningful results. In addition, we do not provide assurance that the System is or will become Year 2000 compliant, that System's Year 2000 remediation efforts will be successful in whole or in part, or that parties with which the System does business are or will become Year 2000 compliant.



Sacramento, California
September 22, 1999

California State Teachers' Retirement System
State Teachers' Retirement Plan
Schedule of Funding Progress
June 30, 1999

Schedule I

| Actuarial Valuation Date as of June 30 | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) (b) | Unfunded AAL (UAAL) (b-a) | Funded Ratio (a/b) | Covered Payroll (c) | UAAL as a % of Covered Payroll (b-a)/c) |
|---|--|--|--|-----------------------------------|------------------------------------|--|
| Defined Benefit Program ⁽³⁾ (dollars in millions): | | | | | | |
| 1999 | (1) | (1) | (1) | (1) | (1) | (1) |
| 1998 | \$ 77,290 | \$ 74,234 | \$ (3,056) | 104 % | \$ 15,741 | (19) % |
| 1997 | 67,980 | 69,852 | 1,872 | 97 % | 14,521 | 13 % |
| 1996 | (2) | (2) | (2) | (2) | (2) | (2) |
| 1995 | 55,207 | 63,391 | 8,184 | 87 % | 12,688 | 65 % |
| 1994 | (2) | (2) | (2) | (2) | (2) | (2) |

Cash Balance Benefit Program ⁽³⁾ (dollars in thousands):

| | | | | | | |
|------|--------|----------|--------|---------|-----------|------|
| 1999 | (1) | (1) | (1) | (1) | (1) | (1) |
| 1998 | \$ 790 | \$ 1,728 | \$ 938 | 46 % | \$ 18,838 | 5 % |
| 1997 | (393) | 164 | 557 | (240) % | 4,504 | 12 % |

- (1) The 1999 actuary reports will be available during the year ended June 30, 2000.
- (2) Prior to June 30, 1998, no actuarial reports were prepared in even numbered years. No estimation using actuarial methodology is made in years between valuations.
- (3) Effective January 1, 1999, the Defined Benefit Plan (DB Plan) and the Cash Balance Plan (CB Plan) merged to establish the State Teachers' Retirement Plan which includes the Defined Benefit Program (DB Program) and the Cash Balance Benefit Program (CBB Program). All actuarial data prior to year ended June 30, 1999, relates to the DB Plan and CB Plan.

California State Teachers' Retirement System
State Teachers' Retirement Plan
Schedule of Contributions from Employers and Other Contributing Entities
June 30, 1999 **Schedule II**

| Year Ended June 30 | Annual Required Contribution (a) | Contributed By Employers⁽¹⁾ (b) | Contributed By the State⁽²⁾ (c) | Total Contributed (b + c) | Percentage Contributed (b + c)/a) |
|-----------------------------------|---|---|---|--|--|
|-----------------------------------|---|---|---|--|--|

Defined Benefit Program⁽³⁾ (dollars in millions):

| | | | | | |
|------|----------|----------|--------|----------|------|
| 1999 | \$ 1,473 | \$ 1,492 | \$ 209 | \$ 1,701 | 115% |
| 1998 | 1,911 | 1,419 | 587 | 2,006 | 105% |
| 1997 | 1,835 | 1,299 | 550 | 1,849 | 101% |
| 1996 | 1,726 | 1,196 | 530 | 1,726 | 100% |
| 1995 | 1,589 | 1,111 | 519 | 1,630 | 103% |
| 1994 | 1,586 | 1,126 | 518 | 1,644 | 104% |

Cash Balance Benefit Program⁽³⁾ (dollars in thousands):

| | | | | | |
|------|--------|--------|------|--------|------|
| 1999 | \$ 560 | \$ 560 | \$ - | \$ 560 | 100% |
| 1998 | 772 | 772 | - | 772 | 100% |
| 1997 | 74 | 74 | - | 74 | 100% |

(1) For DB Program, year ended June 30, 1998 and earlier, amounts include employer contributions under Education Code Sections 22950 to 22953. For the year ended June 30, 1999, amounts include employer contributions under Education Code Sections 22950 and 22951.

(2) For DB Program, includes state contributions under Section 22955.

(3) Effective January 1, 1999, the DB Plan and the CB Plan merged to establish the STRP which includes the DB Program and the CBB Program. All actuarial data prior to year ended June 30, 1999, relates to the DB Plan and CB Plan.

California State Teachers' Retirement System **State Teachers' Retirement Plan** **Schedule of Contributions from Employers and Other Contributing Entities** **June 30, 1999** **Schedule II**

The information presented in the Supplementary Schedules 1 and 2 was determined as part of the actuarial valuations at June 30, 1998. Additional information is as follows:

| | DB Plan | CB Plan |
|-----------------------------------|---|----------------------------|
| Actuarial Cost Method | Entry age normal | Traditional Unit Credit |
| Amortization Method | Level percent of payroll | Not applicable |
| Amortization Period | Open | Not applicable |
| Remaining Amortization Period | Not applicable | Not applicable |
| Asset Valuation Method | Expected value with 25% adjustment to market value | Market value of net assets |
| Actuarial Assumptions: | | |
| Investment rate of return | 8.0% | 6.5% |
| Projected salary increases | 5.5% | 5.5% |
| Consumer price inflation | 4.5% | 4.5% |
| Post-retirement benefit increases | 2.0% simple | Not applicable |

The above assumptions for DB Plan were not changed from the previous actuarial valuation as of June 30, 1997. The investment rate of return assumption for the CB Plan decreased from 7.0% as of the June 30, 1997, actuarial report to 6.5% as of June 30, 1998.

California State Teachers' Retirement System
State Teachers' Retirement Plan
Schedule of Administrative Expenses
For the Year Ended June 30, 1999
(in thousands)

Schedule III

| | |
|--|------------------|
| Personal services: | |
| Salaries and wages | \$ 19,080 |
| Staff benefits | 4,923 |
| Accrued vacations | 290 |
| Total personal services | <u>24,293</u> |
| Operating expenses and equipment: | |
| General expense | 1,014 |
| Depreciation expense | 74 |
| Printing | 680 |
| Communications | 809 |
| Postage | 585 |
| Insurance | 10 |
| Travel | 222 |
| Training | 164 |
| Facilities operations | 2,664 |
| Consultants and professional services | 4,434 |
| Consolidated data center: | |
| Consultants and professional services | 1,884 |
| Data processing: | |
| Consultant and professional services | 5,348 |
| Software and other | 336 |
| Central administrative services | 825 |
| Equipment | 281 |
| Other | 394 |
| Total operating expenses and equipment | <u>19,724</u> |
| Total current year expenses that are budgeted | 44,017 |
| Past prior year expenses, net | <u>1,021</u> |
| Total | <u>\$ 45,038</u> |
| Fund sources: | |
| SBMA/administration expense | \$ 63 |
| Reimbursements | 542 |
| Accrued vacation expense | 290 |
| Refunds to reverted appropriation | (10) |
| Budget Act, Chapter 162, Statutes 1996 | 548 |
| Reappropriated Chapter 162, by Chapter 282/97 | 825 |
| Budget Act, Chapter 282, Statutes 1997 | (352) |
| Budget Act, Chapter 324, Statutes 1998 | 42,669 |
| Legislation, Chapter 968, Statutes 1998 (Health Study) | 199 |
| Budget Act, Chapter 592, Statutes 1995 | 264 |
| Total fund sources | <u>\$ 45,038</u> |

California State Teachers' Retirement System
State Teachers' Retirement Plan
Schedule of Investment Expenses from Continuous Appropriation
For the Year Ended June 30, 1999
(in thousands)

Schedule IV

External equity managers:

Domestic:

| | |
|-----------------------------------|--------------|
| Ariel Capital Management | \$ 118 |
| Barclays Global Investors | 554 |
| Brown Capital Management Inc. | 448 |
| Delphi Management, Inc. | 65 |
| Denver Investment Advisor Inc. | 1,624 |
| DSI International Management | 338 |
| First Quadrant | 293 |
| Mellon Capital Management | 408 |
| NCM Capital Management Group Inc. | 672 |
| Oppenheimer Capital | 381 |
| Putnam Investments | 297 |
| Sasco Capital, Inc | 751 |
| State Street Bank Global Advisors | 338 |
| TCW Asset Management | 83 |
| Total domestic | <u>6,370</u> |

International:

| | |
|--|---------------|
| Bank of Ireland | 2,066 |
| Barclays Global Investors | 2,389 |
| Capital Guardian Trust | 3,355 |
| Invesco | 1,257 |
| J P Morgan Investment Management | 791 |
| Lazard Freres Asset Management | 2,775 |
| Morgan Stanley | 1,786 |
| Oechsle International Advisors | 3,576 |
| Schroder Capital Management Investment, Ltd. | 1,337 |
| Scudder Kemper | 1,914 |
| State Street Global Advisors | 760 |
| Total international | <u>22,006</u> |

California State Teachers' Retirement System
State Teachers' Retirement Plan
Schedule of Investment Expenses from Continuous Appropriation
For the Year Ended June 30, 1999
(in thousands)

Schedule IV

| | |
|--|------------------|
| Global: | |
| Baring International | \$ 2,424 |
| Brinson Partners | 1,919 |
| Fiduciary Trust International | <u>2,185</u> |
| Total global | <u>6,528</u> |
| Total external equity managers | <u>34,904</u> |
| Real estate managers/advisors: | |
| Lend Lease | 1,826 |
| MIG Realty Advisors, Inc. | 386 |
| O'Connor Realty Advisor Inc. | 92 |
| SSR Realty Advisors | 412 |
| Trust Company of the West | <u>2,144</u> |
| Total real estate managers/advisors | <u>4,860</u> |
| Advisors and consultants: | |
| Briggs Wengert LLP | 100 |
| Thomas Flanigan, Inc. | 10 |
| Pathway Capital Management, LLC | 733 |
| Pension Consulting Alliance | 570 |
| Watson Wyatt Worldwide | <u>1</u> |
| Total advisors and consultants | <u>1,414</u> |
| Attorneys, master custodian and insurers: | |
| Fulbright & Jaworski | 13 |
| Groom Law Group (formerly Groom & Nordberg) | 43 |
| Kanter Immigration Law Office | 4 |
| Near North Insurance Brokerage | 262 |
| Orrick, Herrington & Sutcliffe | 16 |
| State Street Bank & Trust Co. | <u>3,188</u> |
| Total attorneys, master custodian and insurers | <u>3,526</u> |
| Other Expenses: | |
| Cortex Applied Research, Inc. | 28 |
| PricewaterhouseCoopers LLP | 32 |
| State Controller's Office | 13 |
| Miscellaneous | 76 |
| Travel | <u>121</u> |
| Total other expenses | <u>270</u> |
| Total continuous appropriations | <u>\$ 44,974</u> |

California State Teachers' Retirement System
State Teachers' Retirement Plan
Schedule of Consultant and Professional Services Expenses
For the Year Ended June 30, 1999
(in thousands)

Schedule V

| INDIVIDUAL OR FIRM | COMMISSION/ FEE | NATURE OF SERVICE |
|--|--------------------|-----------------------------------|
| Consulting and professional services: | | |
| Alameda County Office of Education | \$ 71 | Regional Counseling Services |
| Bay Brook Medical Group, Inc. | 65 | Disability Evaluation |
| Carole Nimietz M. ED., C.R.C. | 21 | Vocational Assesments and Reports |
| Contra Costa County Office of Education | 72 | Regional Counseling Services |
| Cooperative Personnel Services | 52 | Consulting Services |
| Department of General Services | 46 | Hearing Office Charges |
| Department of Justice | 455 | General Services Legal Fees |
| Department of Personnel Administration | 13 | Legal Services |
| Fresno County Office of Education | 60 | Regional Counseling Services |
| Gary R. Hudak, M. D. | 14 | Disability Evaluation |
| Geary & Associates, Inc. | 11 | Vocational Assesments and Reports |
| Goldfarb & Associates | 24 | Vocational Assesments and Reports |
| Hogan & Hartson | 150 | Advocate and Legal Representation |
| Jeff Beeman Vocational Services | 11 | Vocational Assesments and Reports |
| Kathleen M. Ogburn | 14 | Vocational Assesments and Reports |
| Kern County Supt. of Schools | 49 | Regional Counseling Services |
| Liebman & Associates | 78 | Vocational Assesments and Reports |
| Linville Associates | 18 | Vocational Assesments and Reports |
| Los Angeles County Supt. of Schools | 104 | Administrative Services |
| Los Angeles County Supt. of Schools | 440 | Regional Counseling Services |
| Mattox Group | 72 | Vocational Assesments and Reports |
| Merced County Office of Education | 17 | Regional Counseling Services |
| Meta Dynamics | 20 | Consultant Training |
| Orange County Department of Education | 115 | Regional Counseling Services |
| PricewaterhouseCoopers LLP | 114 | Audit and Consulting Services |
| San Bernardino County | 130 | Regional Counseling Services |
| San Diego County Office of Education | 27 | Regional Counseling Services |
| San Diego Unified School District | 202 | Regional Counseling Services |
| San Joaquin County Office of Education | 59 | Regional Counseling Services |
| San Juan Unified School District | 120 | Regional Counseling Services |
| San Mateo-Foster City School District | 65 | Regional Counseling Services |
| Santa Barbara County Office of Education | 52 | Regional Counseling Services |
| Santa Clara Unified School District | 107 | Regional Counseling Services |
| Santa Cruz County Office of Education | 49 | Regional Counseling Services |
| Shasta County Office of Education | 69 | Regional Counseling Services |
| Sonoma County Supt. of Schools | 48 | Regional Counseling Services |
| State Controller's Office | 698 | Various Financial Services |
| Superior Rehabilitation Services | 52 | Vocational Assesments and Reports |
| Susan O'Loughlin Ward | 45 | Consulting Services |
| Towers, Perrin, & Forester | 33 | Consulting Services |
| Travel/Tuition | 87 | Medical Reimbursement |
| Tulare County Supt. of Schools | 18 | Regional Counseling Services |

California State Teachers' Retirement System
State Teachers' Retirement Plan
Schedule of Consultant and Professional Services Expenses
For the Year Ended June 30, 1999
(in thousands)

Schedule V

| INDIVIDUAL OR FIRM | FEE | NATURE OF SERVICE |
|---|------------------|------------------------------|
| Ventura County Supt. of Schools | \$ 37 | Regional Counseling Services |
| Watson Wyatt Worldwide | 128 | Actuarial Services |
| William M. Mercer, Inc. | 152 | Consulting Services |
| Xerox Professional Services | 35 | Employee Survey |
| Other | <u>105</u> | Various Services under \$10 |
| | <u>4,424</u> | |
| Data processing: | | |
| Compucom Systems, Inc. | 25 | Data Processing |
| Computer Resources Group, Inc. | 115 | Data Processing |
| Nanran, Inc. | 686 | Data Processing |
| Piolt Computer Services, Inc. | 35 | Data Processing |
| Science Applications | 91 | Data Processing |
| SPL Worldgroup Consulting | 3,400 | Data Processing |
| Synergy Consulting, Inc. | 360 | Data Processing |
| Visionary Integration | 590 | Data Processing |
| Visual Communications | <u>46</u> | Data Processing |
| | <u>5,348</u> | |
| Consolidated Data Center: | | |
| Stephen P. Teale Data Center | 1,875 | Data Processing |
| Health & Welfare Data Center | <u>19</u> | Data Processing |
| | <u>1,894</u> | |
| Total consultant and professional services expenses | \$ <u>11,666</u> | |

California State Teachers' Retirement System
Cash Balance Plan
Schedule of Administrative Expenses
For the Six-Month Period Ended December 31, 1998
(in thousands)

Schedule VI

| | |
|--|---------------|
| Personal services: | |
| Salaries and wages | \$ 136 |
| Staff benefits | <u>30</u> |
| Total personal services | <u>166</u> |
| Operating expenses and equipment: | |
| General expense | 106 |
| Printing | 4 |
| Communications | 4 |
| Postage | 3 |
| Travel | 9 |
| Training | 1 |
| Facilities operations | 15 |
| Consultants and professional services | 36 |
| Software and other | 1 |
| Central administrative services | <u>42</u> |
| Total operating expenses and equipment | <u>221</u> |
| Total | <u>\$ 387</u> |
| Fund sources: | |
| Budget Act, Chapter 592, Statutes 1995 | <u>\$ 387</u> |
| Total fund sources | <u>\$ 387</u> |

California State Teachers' Retirement System
Cash Balance Plan
Schedule of Consultant and Professional Expenses
For the Six-Month Period Ended December 31, 1998
(in thousands)

Schedule VII

| INDIVIDUAL OR FIRM | COMMISSION/ FEE | NATURE OF SERVICE |
|---|--------------------|---------------------|
| Consulting and professional services: Watson Wyatt Worldwide | \$ <u>36</u> | Consulting Services |

California State Teachers' Retirement System
403(b) Program
Schedule of Administrative Expenses
For the Year Ended June 30, 1999
(in thousands)

Schedule VIII

| | |
|---|---------------|
| State Street Bank administrative fees | \$ 190 |
| State Teachers' Retirement Plan sponsor fee | <u>15</u> |
| Total | <u>\$ 205</u> |

California State Teachers' Retirement System

Disclosures about Year 2000 Issues

For the Year Ended June 30, 1999

Schedule IX

Disclosure of Year 2000 Issues and Activity

The Governmental Accounting Standards Board (GASB) identified the Year 2000 date problem as affecting a wide range of governmental activities that could have a significant impact on an entity's future financial resources. In response to this concern, the GASB has directed governmental entities to disclose information concerning the general description of the Year 2000 issue as it relates to their organization, the resources committed to resolving the Year 2000 problem, and the stage or stages the organization is at in resolving this problem.

General Description of the Year 2000 Problem as it Relates to the State Teachers' Retirement System (System)

The System has identified the following mission critical and non-mission critical systems and equipment to ensure that the systems are Year 2000 compliant:

- On-line Information System
- STRS Net Lan-Wan
- External Interfaces
- Accounting System
- Cash Balance System
- Personal Computers
- Computer Assisted Retrieval (CAR) System
- Embedded chip systems
- Non-Mission Critical Equipment

Resources Committed

Significant personnel and financial resources have been devoted to this project since 1996. For the year ended June 30, 2000, the System has budgeted less than \$50,000, including outside contractors, for completion of this project.

STAGES OF WORK

Awareness Stage

In 1996, the System initiated a complete review of the organization by end-users. The individual end-users from each department had the opportunity and responsibility to identify potential business operations or services requiring review for Year 2000 compliance. The department then established a plan for ensuring Year 2000 compliance.

Assessment Stage

In November 1996, a departmental cross functional team performed an assessment of critical and non-critical functions necessary for the System to continue the business operation of the organization.

Remediation

The development and modification stages of the project were completed in March 1999. In addition, contingency plans have been developed in case one or more business partners are unable to become Year 2000 compliant. The business partners that the System has been working with include several California State agencies and counties, banking partners, communication providers, and the master custodian for investments.

California State Teachers' Retirement System
Disclosures about Year 2000 Issues
For the Year Ended June 30, 1999

Schedule IX

Validation and Testing

The System completed the validation and testing of all mission critical and non-mission critical system in June 1999. The completion of validation and testing of contingency plans is planned to be completed by October 1999.

Although the plan has been established and significant work has been completed, there is no guarantee that the systems and equipment of the System will be Year 2000 compliant.